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*[Proposed] Counsel for Debtors  
and Debtors in Possession*

**UNITED STATES BANKRUPTCY COURT  
DISTRICT OF NEVADA**

In re:  
CARBON ENERGY HOLDINGS, INC.  
Debtor.

Case No. 11-52099-btb  
Chapter 11

In re:  
CARBON ENERGY RESERVE, INC.  
Debtor.

Case No. 11-52101-btb  
Chapter 11  
(Jointly Administered)

**DECLARATION OF GORDON F. LEE IN SUPPORT OF DEBTORS'  
MOTION TO REJECT EXECUTORY CONTRACT  
WITH BEARTOOTH LAND COMPANY, LP**

GORDON F. LEE hereby states and declares as follows:

1. I am now, and at all times material herein was, over the age of 18, and I am competent to testify and to be a witness as to the facts stated herein.

2. I have personal knowledge of the facts stated herein, except for those matters stated upon information and belief, and as to those matters, I believe them to be true.

3. I am a member of the board of directors and the president of Debtor Carbon Energy Holdings, Inc. ("CEHI"). I am also the president and a member of the board of directors

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1 and the president of Debtor Carbon Energy Reserve, Inc. ("CER").

2 4. Debtor CEHI is the sole shareholder and 100% owner of Debtor CER.

3 5. Both of the Debtors are governed by the same officers and board of directors,  
4 which consist of Gordon F. Lee ("Lee"), Victoria J. Blackburn ("Blackburn") and Norbert H.  
5 Kmoch ("Kmoch").

6 6. Debtor CEHI's only asset of significance is its ownership interest in Debtor CER,  
7 which in turn owns certain surface rights and the mineral rights to a large deposit of coal located  
8 on approximately 8,200 contiguous acres of real property in Carbon County, Montana (the "Coal  
9 Rights"), which CER or its predecessors have held since at least 1976.

10 7. In 2006, the ownership structure of Debtor CER was reorganized, and CEHI was  
11 established as the sole shareholder of CER. In connection with the 2006 reorganization, a  
12 business plan was adopted under which Raymond L. Lowrie, Cory J. Coppage, Howard H. Potter,  
13 Louis F. Coppage and David S. Woolf (collectively, the "Former Managers") became officers  
14 and/or directors of the Debtors.

15 8. From 2006 through 2010, the Former Managers failed to hold any annual meeting  
16 of shareholders of either CEHI or CER and were generally unsuccessful in their efforts to  
17 develop and market the Coal Rights as anticipated under the 2006 business plan.

18 9. As a result, in 2010 shareholders controlling approximately 56.7% of the voting  
19 stock of CEHI voted by written consent in lieu of an annual meeting to remove the Former  
20 Managers from their positions as officers and directors of CEHI and elected Lee, Blackburn and  
21 Kmoch as directors of CEHI effective as of October 31, 2010. A true and correct exemplar copy  
22 one such written shareholder consent is attached hereto as Exhibit 1.

23 10. On December 7, 2010, the board of directors of CEHI met and elected Lee,  
24 Blackburn and Kmoch to serve as the officers of CEHI. A true and correct copy of the minutes  
25 of the December 7, 2010 meeting of the board of directors of CEHI is attached hereto as Exhibit  
26 2.

27 11. On December 7, 2010, CEHI, as the sole shareholder of CER, voted by written  
28 consent in lieu of an annual meeting of shareholders to elect Lee, Blackburn and Kmoch as the



1 officers and directors of CER. A true and correct copy of this written consent is attached hereto  
2 as Exhibit 3.

3 12. After learning that they had been displaced as officers and directors of the  
4 Debtors and after initially agreeing to vacate their positions as such, the Former Managers sent a  
5 letter to the shareholders of CEHI on or about December 15, 2010 in which they claimed that  
6 they remained in control of CEHI and called for a special meeting of shareholders of CEHI to  
7 take place on January 7, 2011 for the purpose of electing officers and directors of CEHI. A true  
8 and correct copy of this letter is attached hereto as Exhibit 4.

9 13. A special meeting of shareholders of CEHI took place on January 7, 2011;  
10 however, the Former Managers caused the meeting to be adjourned until February 10, 2011  
11 before the shareholders were able to elect officers or directors. A true and correct copy of the  
12 minutes of the January 7, 2011 special shareholder meeting for CEHI is attached hereto as  
13 Exhibit 5.

14 14. The special meeting of shareholders of CEHI reconvened on February 10, 2011 at  
15 which time shareholders controlling at least 60% of the voting stock of CEHI again voted to  
16 remove the Former Managers from their positions as officers and/or directors of CEHI and  
17 elected Lee, Blackburn and Kmoch as directors of CEHI. A true and correct copy of the minutes  
18 of the February 10, 2011 special shareholder meeting for CEHI is attached hereto as Exhibit 6.

19 15. Notwithstanding the fact that they had previously been removed from their  
20 positions as officers and/or directors of CEHI and CER, the Former Managers entered into an  
21 asset purchase contract (the "Asset Purchase Contract") with Beartooth Land Company, LP  
22 ("Beartooth") on or about April 13, 2011 under which the Former Managers agreed to sell the  
23 Coal Rights to Beartooth for \$10,000,000 and potential non-cash future royalties. Upon  
24 information and belief, a true and correct copy of the Asset Purchase Contract is attached hereto  
25 as Exhibit 7.

26 16. In connection with the Asset Purchase Contract, the Former Managers also  
27 entered into an exploration access agreement with Beartooth (the "Access Agreement") on April  
28 29, 2011 under which the Former Managers purportedly granted Beartooth temporary surface

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1 access to the Coal Rights for testing purposes. Upon information and belief, a true and correct  
2 copy of the Access Agreement is attached hereto as Exhibit 8.

3 17. The Former Managers had no actual authority to enter into the Asset Purchase  
4 Contract or the Access Agreement on behalf of CEHI or CER. Moreover, neither the Asset  
5 Purchase Contract nor the Access Agreement were ever presented to or voted upon by CEHI's  
6 shareholders.

7 18. Upon information and belief, neither the Debtors, nor Beartooth has tendered any  
8 performance under the Asset Purchase Contract or the Access Agreement.

9 19. The consideration to be paid by Beartooth in exchange for the Coal Rights under  
10 the Asset Purchase Contract is far below the actual fair market value of the Coal Rights, which  
11 Debtors conservatively estimate to be worth at least \$40,000,000.

12 20. The consideration to be paid by Beartooth under the Asset Purchase Contract is  
13 unlikely to be sufficient to provide any significant return to shareholders.

14 21. Accordingly, I believe it is in the best business interest of the Debtors to reject the  
15 Sales Contract and Access Agreement in order to allow the Debtors the opportunity to realize the  
16 full value of the Coal Rights.

17 I declare under penalty of perjury that the foregoing is true and correct.

18 DATED this 9<sup>th</sup> day of August, 2011.

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21   
22 GORDON F. LEE  
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